

## **ISSUES TO CONSIDER IN WHOLESALE WATER SUPPLY AGREEMENT NEGOTIATIONS**

### **I. Quantity.**

#### **A. Minimum Quantity (“Take or Pay Provision”)**

1. Suppliers should consider establishing a minimum amount that the Purchaser must purchase when a portion of the Supplier’s facilities must be available to supply the Purchaser’s demand and such sales are factored into the Supplier’s decisions regarding repayment of debt incurred to finance the construction of water treatment or distribution facilities necessary to supply the Purchaser. Suppliers should consider minimum quantity provision when additional facilities must be constructed to serve Purchaser’s demand.

2. Specifying a minimum quantity obligates a Purchaser to purchase a minimum amount regardless of whether it has actual need for that amount. The Purchaser must pay for minimum volume regardless of whether it actually takes that amount. Such provision also requires the Supplier to maintain sufficient capacity to meet this quantity.

3. Defining minimum quantity. Is the amount of minimum determined on total volume purchased over a time period (e.g., weekly, monthly, annually)? Should minimum quantity be determined as a flow volume (e.g., 1,000 gallons per hour)? Both Supplier and Purchaser must consider operational factors. For example, if the purchase of 1,000,000 gallons that is evenly spread over a 30-day period requires less production or storage capacity than if the purchase is concentrated in 7-day period. Possible options:

- a. Monthly Amount
- b. Daily Amount
- c. Flow amount (gallons per minute)
- d. Flow amount at specific delivery points

#### **B. Maximum Quantity**

1. Specifying a maximum quantity obligates the Supplier to maintain sufficient capacity to meet this quantity. Failure to maintain the ability to meet that obligation will make Supplier vulnerable to possible action from the Public Service Commission or a court to require the construction of additional facilities to meet minimum quantity requirements.

2. Ensures that a definite quantity will be available to Purchaser.

3. Defining maximum quantity. Is the amount of maximum determined on total volume purchased over a time period (e.g., weekly, monthly, annually)? Should maximum quantity be determined as a flow volume (e.g., 1,000 gallons per hour)? Both Supplier and Purchaser must consider operational factors. For example, if the purchase of 1,000,000 gallons that is evenly spread over a 30-day period requires less production or storage capacity than if the purchase is concentrated in 7-day period.

4. Contingencies When Purchaser Exceeds Maximum Quantity

a. Penalty Rate. Purchaser pays a higher rate for volumes in excess of maximum volume.

b. Usage Zone. Contract specifies a zone in which Purchaser is permitted to exceed maximum amount by a specific amount on a limited number of occasions (e.g., Purchaser may take no more than 10 percent above maximum amount on no more than 3 billing periods during calendar year).

5. Purchaser/Supplier consideration: If water supply contract specifies a maximum amount, maximum amount may be used to support claim that fixed costs associated with the portion of total capacity used to supply maximum amount should be allocated to the Purchaser when determining price.

**C. Total Requirements:** Contracts may specify that the Supplier agrees to provide Purchaser's total requirements or that the Purchaser agrees to take total requirements from Supplier. Such provisions are **not recommended** because they limit a purchaser's flexibility and impose significant liabilities on a supplier. Such provisions prevent a purchaser from using lower cost suppliers. While a lower cost supplier may not be available when the purchased water contract is executed, the possibility exists that such providers may appear during the term of the contract. A supplier must be concerned about a purchaser's requirements exceeding the supplier's capacity. If that event occurs, the supplier can be required to construct additional capacity to meet the purchaser's demand.

**D. Purchases from Other Sources.** Is there any limitation upon Purchaser's right to purchase water from other sources? If no, Purchaser should consider requesting contract provision that Supplier waives its rights under 7 U.S.C. §1926 to exclusive provision of water service for amounts in excess of contract minimum.

## **II. Capacity.**

**A. Specific Reservation of Capacity to Purchaser.** Contract should provide the amount of capacity that the Supplier is expressly reserving to the Purchaser. Supplier must provide this amount of capacity to the Purchaser. Where a specific reservation is made, the supplier is likely to allocate the cost of that portion of the plant (including debt service) to the purchaser when determining the wholesale cost.

### **B. Future Capacity Needs**

1. What obligations does the Supplier have to supply increases in Purchaser's demand?

2. Anticipating Future Demand

#### **a. Purchaser's Obligations**

(1) Should Purchaser be required to notify and seek the Supplier's approval before adding customers with potentially large demand?

(2) Should Purchaser be required to obtain Supplier's approval before reselling water to another water utility?

(3) What are Purchaser's obligations to participate or assist in demand projection studies?

(4) What are Purchaser's obligations to provide advance notice of events that may affect capacity needs (e.g., renewal of contract, purchase of water from other sources)?

#### **b. Supplier's Obligations**

(1) Does Supplier have any obligation to inform Purchaser regarding existing capacity issues or to inform about plans for additions of capacity?

(2) Does Supplier have any obligation to include Purchaser in planning process?

### **C. Conservation/Demand Side Management.**

1. What are Supplier's obligations to develop water shortage response plan?

2. What are Purchaser's obligations to comply with any Supplier water shortage, conservation or demand side management program?
3. What are the responsibilities of Purchaser and Supplier to coordinate conservation plans?
4. What allocation of storage capacity to Purchaser when Supplier experiences reduction of water supply?

**D. Emergencies.**

1. How will water be allocated to Purchaser in the event of interruption of Supplier's supply? (Consider different types of disruption, e.g., drought, equipment breakdown at treatment plant or key distribution facility).
2. What are Purchaser's obligations to implement conservation measures in the event of emergency?
3. What are Supplier's obligations in the event of natural disaster/emergency?

**III. Rate.**

**A. Initial Rate (Basis for Rate)**

**B. Adjustments in Rates**

1. Frequency of Rate Adjustments – How often may the rate be adjusted? How much time must elapse between rate adjustments? Does Supplier have discretion to adjust when it determines that adjustment is necessary?
2. Upon what basis should adjustments be made?
  - a. Cost-of-service study
  - b. Automatic adjustment clauses
  - c. Formulas
  - d. RD standard - "Demonstrable increase or decrease in the cost of performance"
3. Cost-of-Service Study: Should a cost-of-service study be performed before adjusting its rates?

- a. Who should conduct the study?
  - (1) Should decision to conduct study be at the Supplier's discretion?
  - (2) What role of Purchaser in the selection of the person or entity conducting the study?
- b. How frequently should a cost-of-service study be conducted?
- c. May an existing cost-of-service study be used and updated to reflect present conditions?
- d. Agreed assumptions/cost allocations or formulas that must be used in the cost-of-service study?
- e. What are the rights of Purchaser/Supplier to review and comment upon study and obligation of study's preparer to consider?

#### 4. Automatic Adjustment Provisions

- a. Rate Indexing. Rate adjustment is based upon an agreed price index. **Note:** Public Service Commission has not accepted adjustments based upon a price index and has required wholesale providers to demonstrate that the index accurately reflects changes in the cost of providing water service.
- b. Adjustments to reflect changes in the cost of certain components of providing service (e.g., taxes, Kentucky River Authority withdrawal fees, purchased power, chemical).

#### 5. Formula.

- a. Cost elements that should be included when determining rate.
- b. Cost elements that should be specifically excluded.

### C. Adjustment in Rates – Notice.

- 1. What notice, if any, must Supplier provide to utility before adjusting rates? **Note:** KRS 278.180 requires Supplier to provide the Commission and the Purchaser with 30 days advance notice of proposed adjustment.

Purchaser may desire additional notice to ensure sufficient time to adjust its retail rates.

2. **Billing Cycle Considerations.**

a. Supplier may charge the adjusted rate for service rendered on and after the effective date of the adjusted rate. It cannot charge the adjusted rate for service provided before the effective date even if the bill for such service is rendered after the effective date. Supplier should ensure that the effective date will be synchronized with its meter reading date to prevent problems calculating the wholesale bill at the adjusted rate.

b. Purchaser has similar considerations. It may wish to have Supplier make a rate adjustment effective on a date that will permit the Purchaser to synchronize its meter reading with the new wholesale rate and any purchase water adjustment that it intends to implement. (For example, Purchaser's meter reading occurs on the 3<sup>rd</sup> Monday of the month. To reduce billing problems for Purchaser, any rate adjustment would not become effective until 3<sup>rd</sup> Tuesday of month).

**IV. Master Meter Issues.**

**A. Ownership of Meter – Who owns the meter(s)?**

**B. Who has actual control of the Meter?**

**C. Access:** Does the Purchaser have equal access to meter to permit reading at any time?

**D. Testing and Accuracy**

1. Frequency of Testing – How often will the master meters be tested?

2. Notice of Testing to Purchaser (Advanced Notice/Post-Testing Notice) – What notice must the Supplier provide to the Purchaser prior to pulling and testing the wholesale meter?

3. Notice of Test Results Provided to Purchaser – What obligations to share the results of meter tests does the Supplier have to the Purchaser?

4. Purchaser's Right to Request Test – Does the Purchaser have the right to demand the testing of the wholesale meters? What are the limits, if any, on this right?

5. Responsibility for Testing Costs. Who is responsible for costs of regularly scheduled testing? Who is responsible for costs of Purchaser Requested Tests? Who is responsible for costs of Purchaser Requested Tests when inaccurate meter is found?

6. Use of Third Parties to Conduct Testing – Required Certification

**E. Meter Reading**

1. Frequency – How often should the wholesale meter be read?

2. Date of Reading – On what day should the meter be read by the Supplier? Purchaser should consider requesting a date that can be synchronized with its retail billing practices.

3. Notice to Purchaser of Reading – What advanced notice must the Supplier give to the Purchaser that wholesale meter will be read?

4. Right of Purchaser to Accompany Supplier's Reader Under Reasonable Conditions. Purchaser should request language that permits his agent or employer to accompany Supplier's reader to ensure accuracy of meter readings and billings.

**F. Maintenance**

1. Which party is responsible for maintaining the meter?

2. Which party is responsible for the costs incurred to maintain or repair the meter?

**G. Replacement**

1. Under what conditions will a master meter be replaced?

2. What party assumes cost of replacement meter?

**V. Water Quality.**

**A. Compliance with all Division of Water (DOW) Standards.** Contract should have a provision requiring the purchased water to comply with all DOW standards.

**B. Responsibility for compliance costs incurred in the event of non-compliance**

1. Will Purchaser be reimbursed for its cost of customer notification when non-compliance with DOW standards results from Supplier's action (e.g., consecutive systems in which the Supplier is responsible for monitoring for trihalomethanes)?
2. Who is responsible for the cost of actions (e.g., line flushing) to alleviate non-compliance due to Supplier's water?
3. Should Purchaser be indemnified for any fines or penalties assessed that are related to the actions of the Supplier?

**C. Coordination of Supplier-Purchaser Systems** (see 401 KAR 8:510)

1. How is monitoring to be conducted? Who is responsible?
2. What are the duties/responsibilities for joint system responsibility?

**D. Implementation of Disinfection By-Products Rule (Stage II):** New Federal Rule will impose obligation upon the purchasing system to limit the level of disinfection by-products in water delivered to ultimate consumer. Purchasing systems will need to monitor its system to ensure that appropriate levels are not exceeded.

1. What treatment method should be used?
2. What is the maximum level of disinfection by-products in delivered water at the time and point of delivery to Purchaser?
3. What notice should Supplier provide for changes in the method of water treatment?
4. What, if any, specific features of treatment should be applied?

**E. Testing for Water Quality**

1. What is the Purchaser's right to demand water tests for quality and compliance with contract specifications?
2. Who is responsible for cost of testing?
3. Is Supplier responsible for the cost of testing where non-compliance with contract specifications is discovered?

**VI. Point of Delivery.**



**A. List of Points of Delivery.** What is the location of each point of delivery (master meter)?

**B. Process for Purchaser to Obtain Additional Points of Delivery/Cost for Such Points.** If the Purchaser wishes to add delivery points at a future date, what process must the Purchaser follow to request the addition of such points?

**C. Pressure at Delivery Point.** Contract should specify pressure range in which the water will be delivered at the metering point. Parties may wish to make provisions for monitoring pressure at delivery points and establish responsibility for corrective action when pressure is outside of the specified range. (While the supplier will generally be responsible for water pressure at the delivery point, there may be instances that delivery pressure is affected by the Purchaser's actions.)

## **VII. Provisions to Avoid Unnecessary Litigation.**

**A. Good Faith Negotiation:** All parties are required to negotiate in good faith.

**B. Access to Records:** Purchaser should have access at reasonable times and reasonable manner to Supplier's financial and operational records. Procedures and times for obtaining records should be listed. **Note:** Where a municipal utility is a supplier, the municipal utility's records are subject to requests made pursuant to Open Records Act.

**C. Recordkeeping:**

(1) Records need to be kept in a manner to permit a reasonable evaluation of cost.

(2) Should Supplier be required to maintain records in accordance with Kentucky Uniform System of Accounts? Should another recordkeeping system be used?

(3) Should expenses/revenues related to operation of utility function (e.g., water operations) be segregated from all other operations of the Supplier?

**D. Rate Case Expense (Recovery of Expenses Incurred to Obtain PSC Approval of Rate Adjustment):**

(1) What types of expenses (e.g., attorney fees, consultant fees, utility staff time) should be allowed recovery in the Supplier's new rate?

(2) What percentage of these expenses should be allocated for recovery in the wholesale rate?

(3) Over what period should these expenses be allocated?

**E. Arbitration: Use of a neutral third party to resolve contract or rate disputes between Supplier and Purchaser.**

**F. Change of Circumstances:** Allow for revision of contract or renegotiation of contract terms when significant changes in circumstances not envisioned when parties executed contract.

## **VIII. Contract Term.**

**A. Length of Contract (Number of Years).** What is the term of the contract?

**B. Renewal.** Is there a process for renewing a purchase contract or negotiating a new contract?

1. Automatic Renewal – Does the contract automatically renew for a similar term if no party objects? Does the Purchaser or Supplier have the right to automatically extend the contract? If an automatic renewal provision exists, what limits, if any, on that provision exists? How many times may the automatic renewal provision operate?

2. Advance Notice Before Termination. If a party wishes to terminate the contract, how much notice must be given? A Purchaser or Supplier may need substantial time to make arrangements to address the loss of supply or customer.

3. Good Faith Negotiations. Contract should provide that each party is expected to negotiate in good faith.

## **IX. Payment.**

**A. Form of Payment** – What form of payment is acceptable?

**B. Date of Payment** - When is payment due?

**X. PSC Service Regulations:** What, If Any, PSC Regulations Related To Service Should Be Applied To Service That Supplier Provides To Purchaser?